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COMMONWEALTH OF MASSACHUSETTS

BEFORE THE

DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Petition of Western Massachusetts Electric Co, for approval of the issuance of electric rate reduction bonds, pursuant to G.L. c. 164, §§ 1G and 1H.

D. T. E. 00-40

INITIAL BRIEF OF

WESTERN MASSACHUSETTS ELECTRIC COMPANY

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I. INTRODUCTION

On April 18, 2000, Western Massachusetts Electric Company ("WMECO" or the "Company") petitioned the Department of Telecommunications and Energy ("Department") to approve a financing order approving the issuance of electric rate reduction bonds ("RRBs"), pursuant to G.L. c. 164, §§ 1G and 1H, and the Department's September 17, 1999 and December 20, 1999 orders on WMECO's restructuring plan (collectively, the "Restructuring Order"). Chapter 164, § 1H, provides that such a request be acted upon by the Department within 120 days.

As described below, WMECO is eligible to issue the RRBs (and participate in securitization, as that term is used in c. 164, §§ 1G and 1H) because it has complied with each of the requirements of G.L. § 1G(d)(4). With respect to the customer savings mandated by that statutory section, the record in this matter shows that securitization will result in approximately \$19 million in net present value savings and all such savings will inure to the benefit of WMECO's customers. Exh. WM-2, p. 24; Exh. WM-6, p. 4. As the record in this proceeding also makes plain, the Department is not the only public entity involved in the WMECO securitization request. The Massachusetts Development Finance Agency and the Massachusetts Health and Educational Facilities Authority (collectively, the "State Agencies") have been engaged in the development of WMECO's application to the Department. Further, the State Agencies, will oversee the issuance of the RRBs, and will approve the final terms and conditions of the RRBs. Exh. WM-8 (Comments of the State Agencies), p. 1.

Accordingly, WMECO's petition is fully consistent with the requirements of the General Laws and should be approved by the Department.

II. PROCEDURAL HISTORY

Pursuant to the Department's order noticing this proceeding, three parties, the Attorney General, Western Massachusetts Industrial Customer Group ("WMICG") and the State Agencies, requested and were granted full intervenor status. MASSPOWER, Inc., and Fitchburg Gas and Electric Company petitioned for and were granted limited intervenor status. The Department also requested comments on WMECO's petition. The State Agencies were the only party to do so; those comments were filed with the Department on May 30, 2000 and were subsequently entered into the record as Exh. WM-8.

Hearings in this proceeding took place on June 20th and 21st in the offices of the Department. Testifying for the Company were Randy A. Shoop, Assistant Treasurer of WMECO; Richard A. Soderman, Director of Regulatory Policy and Planning for Northeast Utilities Service Company, a service company affiliate of WMECO; and Mark A. Englander, Senior Financial Analyst in the Finance Group of Northeast Utilities System's Treasury Department. No other party presented testimony in this matter.

At the close of hearings, a number of exhibits were received into the record. Entered were Exhibits WM-1 through WM-4 and WM-6 through WM-8; Exhibits AG1-1 through AG1-22; Exhibits WMICG1-1 through WMICG1-11 and WMICG2-1 through WMICG2-12; DTE1-1 through DTE1-31 and DTE2-1 through DTE2-11. In addition, at the hearings the Attorney General issued eight record requests, the WMICG issued one record request and the Department issued three record requests. The Company subsequently responded to these record requests, and these are now part of the record.

III. WMECO'S PLAN FOR SECURITIZING TRANSITION COSTS IS IN FULL COMPLIANCE WITH THE APPLICABLE STATUTORY REQUIREMENTS

General Laws, c. 164, § 1G(d)(4) sets forth the criteria a company must meet in order to be eligible for securitization. That section requires a company to:

fully mitigate the transition costs being securitized through such means as divestiture of its non-nuclear facilities and engaging in good faith efforts to renegotiate existing power purchase contracts;

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provide that savings to ratepayers will result from securitization;

ensure that all savings from securitization will inure to the benefit of ratepayers;

obtain written commitments from the purchasers of its divested operations that all nonmanagerial employees that worked at those divested operations at any time during the three-month period prior to the divestiture will be offered employment by the purchaser at levels of wages and overall compensation no lower than the employees' prior levels; and

establish an order of preference for the use of bond proceeds such that transition costs having the greatest impact on customer rates will be the first to be reduced by those proceeds. (1)

As indicated above, the Department in its Restructuring Order approved WMECO's Restructuring Plan. Pursuant to statute, a company's restructuring plan may be approved only if the company has fully mitigated its transition costs. G.L. c. 164, §§ 1A(a), 1G(d). Accordingly, WMECO has fully mitigated as called for by subsection (i) of G.L. c. 164, § 1G(d)(4) referenced above. As testified by Mr. Soderman, WMECO has completed the divestiture of its nonnuclear facilities as called for by the statute in a two-step process. Exh. WM-2, p. 5. The terms of the divestiture of these facilities has been approved by the Department. D.T.E. 99-29 (1999); D.T.E. 99-74 (2000). In addition, WMECO has endeavored to mitigate, through renegotiation, its two existing purchase power contracts. The buy-down of one such contract has been approved by the Department (D.T.E. 99-56 (1999)) and the buyout of the other contract is pending before the Department (D.T.E. 99-101). (2)

Further, pursuant to the Company's Restructuring Plan approved by the Department, WMECO has in place a nuclear performance-based ratemaking plan related to the Company's remaining nuclear assets, specifically, a share of Millstone unit 2 and Millstone unit 3. Full mitigation of transition costs relating to nuclear facilities was realized when this nuclear performance-based ratemaking plan was put into place. Exh. WM-2, p. 6. (3)

With respect to the second element required, savings to customers, the record is clear that such savings will be produced by securitization. The best estimate for such savings at this time is \$19 million. Exh. WM-2, pp. 24-25, exh. RAS-1, Col. G; Tr. p. 240. The savings, however, could be higher than this amount. See, Exhibit DTE-RR-3, which shows savings of \$21.9 million. As Mr. Soderman stated, the precise level of savings "will depend on the principal repayment schedule, interest rates, actual ongoing transaction costs, amount of credit enhancement, if any, and other factors which will be established at the time the RRBs are priced" (Exh. WM-2, p. 24). There is no evidence on the record of this proceeding contradicting the Company's testimony that savings will be generated.

Beyond a showing that there will be savings from securitization, the Company has demonstrated that all such savings will inure to the benefit of customers. The saving achieved will be passed through in the form of a lower level of transition costs paid by WMECO's retail customers (Exh. WM-2, p. 26). Again, there is no evidence on the record of this proceeding that could form the basis of any contrary finding.

The fourth criteria for securitization, obtaining a written commitment for continued employment at divested facilities, has long since been complied with by WMECO. Such commitments were obtained from the purchasers of WMECO's generation prior to the divestiture. Exh. WM-2, p. 5.

Finally, the last element required in order to be eligible to securitize is a demonstration that bond proceeds will be used in order to have the greatest impact on customer rates. The testimony of Mr. Soderman and Mr. Shoop make the required showing. Mr. Soderman states that WMECO "will securitize those transition costs having the greatest impact on customer rates" (Exh. WM-2, p. 8) and the testimony of

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Mr. Shoop explains how the proceeds of the RRBs will be applied in such a manner as to minimize the weighted cost of capital for the remaining distribution company. (4) Exh. WM-3, pp. 5-13. Attachments 1 and 2 to Mr. Shoop's prefiled testimony explains in detail the application of the RRB proceeds.

As shown above, the WMECO has demonstrated that it fully complies with the eligibility requirements for securitization, as appearing in G.L. c. 164, § 1G(d)(4). There is no basis for any contrary finding.

IV. THE STATE AGENCIES HAVE AN IMPORTANT ROLE IN THE ISSUANCE OF THE RRBs AND THEIR COMMENTS SUPPORTING A NUMBER OF ELEMENTS OF THE PROPOSED SECURITIZATION PLAN SHOULD BE RELIED UPON BY THE DEPARTMENT

The State Agencies have worked with WMECO in the development of WMECO's securitization plan, and the State Agencies' comments to the Department cover a number of elements of the proposal before the Department. As an initial matter the State Agencies have indicated that they have proceeded with the goal of protecting the interest of the Company's customers by: (1) "[e]nsuring the lowest all-in cost possible for the RRBs;" (2) "[s]treamlining the administrative processes and thereby minimizing the costs of issuing the RRBs;" (3) "providing expertise to the Department...regarding the requirements of the Financing Order to allow for the most cost-efficient structure for the issuance of the RRBs." Exh. WM-8, p. 1.

In their comments, the State Agencies have provided positions on certain matters to the Department. The State Agencies state that:

"The Agencies have reviewed the proposed Financing Order contained in [WMECO's] Application to ensure that it meets the legal requirements to issue RRBs. The Agencies believe these requirements are met."

"The Agencies have reviewed the proposed Financing Order to ensure that the RRBs issued thereunder could achieve the highest rating category. The Agencies believe that the proposed Financing Order includes the provisions necessary for the RRBs to achieve the highest possible ratings from all major rating agencies and therefore bear the lowest interest cost."

"The proposed structure includes a Memorandum Account to account for and credit to ratepayers the interest earnings on unremitted collections of RTC Charges, if not remitted daily, and other incidental benefits received by the Company, should there be any. The language of the Financing Order should ensure that any amounts accounted for in the Memorandum Account, as well as any overcollateralization amounts or RTC Charge collections that remain after retirement of the RRBs, are credited to ratepayers, regardless of whether there exists a transition charge." (5)

"The Agencies are presently reviewing with the Company its estimated direct transaction costs and on-going administrative costs. The Agencies' approval of the reasonableness of such costs will be required." (6)

"The Agencies agree with the proposed process by which the Company will remit to the Special Purpose Entity estimated RTC Charge collections based on amounts billed and current cash received and based on a methodology satisfactory to the rating agencies to be designed by the Company."

"The proposed Financing Order provides for annual servicing fee of up to 1.25% of the initial principal balance for servicers who do not concurrently bill the RTC Charge with other service charges to ensure the ability to service these bonds in the event the Company cannot. As long as the servicing remains with the Company or any other entity that concurrently bills other charges, the fee will be .05% of the

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initial principal balance, which the Agencies believe is a reasonable fee and has been determined through negotiations between the Agencies and the Company."

Exh. WM-8, pp. 2-3.

The State Agencies further state that they will continue their oversight of the Company's securitization by:

"approv[ing] the final terms and conditions of the RRBs including structure, pricing, credit enhancement, relevant issue costs and manner of sale, thereby protecting the interests of the ratepayers. The Agencies will also coordinate the marketing of the bonds and the procurement of bond trustees and related services, the selection of rating agencies and the underwriting syndicate to minimize the all-in cost of the RRBs and associated administrative expenses."

Id., p. 1.

Accordingly, in evaluating WMECO's petition, the Department should rely upon the positions of its sister agencies and give great deference to their continued oversight. Both the State Agencies and the Department have the same goal with respect to this proceeding -- namely, to protect the interests of the Company's ratepayers. Exh. WM-8, p. 1.

V. SECURITIZING LESS THAN THE COMPANY HAS PROPOSED WILL DENY RATEPAYERS EASILY ACHIEVABLE SAVINGS IN ORDER TO ADDRESS THE UNLIKELY RISK OF OVERSECURITIZATION, A RISK THAT CAN BE READILY ADDRESSED IN THE MANNER CONTEMPLATED BY THE ELECTRIC RESTRUCTURING ACT

The amount of transition costs proposed to be securitized in WMECO's plan is a reasonable estimate that accounts for anticipated mitigation in the future, while realizing the greatest level of ratepayer savings consistent with the most likely outcome of the nuclear plant divestiture. Any lesser amount would leave ratepayer savings "on the table." There is no benefit in approving a lesser securitization amount out of fear of "oversecuritization". This is because, in that unlikely event, WMECO would credit any payments ratepayers would make to service the debt on the "oversecuritized" amount against other charges on the same bill. An explanation of why WMECO's proposed securitization amount properly balances the interest in greater ratepayer savings against the risk of "oversecuritization" is discussed below.

A. The Proposed Securitization Amount Already Reflects A Reduction For The Estimated Sale Value Of The Nuclear Units And An Additional Buffer Amount.

WMECO's securitization plan anticipates that its Millstone Unit 2 and Unit 3 assets will be sold and the proceeds applied to mitigate transition costs. The amount WMECO proposes to be securitized is accordingly reduced. This adjustment makes it unlikely that proposed securitization amount has been overestimated. An appropriate balance of unsecuritized transition costs will remain on WMECO's books against which to apply the sales proceeds of the nuclear assets as mitigation.

The proposed securitization amounts relating to Millstone Units 2 and 3 have been reduced by approximately \$40 million from the total approved transition costs for these nuclear assets. Exh. WM-2, pp. 11-12; Tr., pp. 98-99. Based on an administrative determination of the value of Millstone Units 2 and 3 in a recent Connecticut proceeding, WMECO's share of the net sale proceeds from the Millstone units is estimated to be approximately \$30 million. Exh. DTE 1-14, citing Order in Connecticut Department of Public Utility Control ("CT DPUC"), Docket No. 99-02-05, p. 46; see also, Exh. WM-2, p. 11 (and Exh. RAS-4, p. 46, attached thereto). In

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addition to the estimated sales price of approximately \$30 million, WMECO has adjusted the transition costs to be securitized down by an additional \$10 million as a buffer, in the event that its share of the Millstone units sell for a higher value than anticipated under the assumptions of the CT DPUC. Exh. WM-2, p. 12; Exh. DTE1-15; Tr., p. 98. Moreover, as explained below, there is, in effect, an additional "buffer" amount caused by the fact that certain costs and other items must be subtracted from the nuclear plant sales proceeds in order to determine net mitigation.

Under the CT DPUC assumptions, the estimated value is \$25/kw for Millstone 2 and \$185/kw for Millstone 3, (see, Exh. WM-2 (Exh. RAS-4, p. 46 attached thereto)) or a weighted average sale value of approximately \$116/kw (total estimated sales price for the two nuclear units divided by the kw capacity of the two units, as derived from Exh. DTE 1-14). This estimate for the Millstone units is higher than the average price of \$90/kw in recent sales of nuclear plants. Tr., pp. 54, 232. Analysis in WMECO witness Soderman's testimony showed that even if the Millstone units sold for an aggregate gross sales price of \$200/kw or some \$60 million gross to WMECO, the \$40 million cushion of unsecuritized transition costs would still be a sufficient amount against which to apply such sales proceeds. This is the case because capital additions made since 1995 worth approximately \$15 million, as well as some \$5 million in anticipated transaction costs, must be deducted from gross sales proceeds in order to arrive at net proceeds. Subtracting \$20 million from \$60 million leaves net proceeds at the \$40 million level proposed. Tr., pp. 99, 233.

Therefore, the transition costs left unsecuritized will be sufficient to absorb the maximum mitigation likely to be achieved from the sale of the Millstone nuclear assets.

B. In The Unlikely Event Of An Overestimate Of Reimbursable Transition Costs Amounts, Periodic Reviews By The Department Of Such Amounts Will Identify Any Overestimate And Provide A Corresponding Ratepayer Credit.

In the event the sales price of WMECO's Millstone Unit 2 and Unit 3 assets far exceeds expected prices (a very positive result for ratepayers because it reduces overall costs to be recovered), the statute provides a mechanism for crediting ratepayers with any difference between transition costs and the securitized dollar amount. Transition costs are subject to periodic reconciliation if the amount of projected stranded costs varies from current estimates. G. L. c. 164, §1A(a). Once such costs are securitized and become by statutory definition "reimbursable transition costs amounts" authorized in a financing order by the Department, they continue to be subject to review.

[T]he department shall review a financing order periodically, at a minimum not less than every 18 months from the inception of the original financing order, to determine if the amount of reimbursable transition costs amounts proved to be accurate. Such review shall be limited to a comparison of assumed costs and assumed mitigation to the actual costs determined through actual mitigation. If the amount of reimbursable transition costs amounts previously included in a financing order exceeds the correct amount of the reimbursable transition costs amounts, then the electric company shall provide ratepayers with a uniform rate credit based on usage that in total equals the amount of the excess including carrying costs or pay to the financing entity an amount equal to such excess and, provided that all reserve funds are fully funded, the financing entity shall use or escrow such funds to redeem or otherwise reduce the amount of the principal of the electric rate reduction bonds .

G. L. c. 164, § 1G(a)(2). (7)

WMECO has submitted testimony and evidence, consistent with this statutory mechanism, that ratepayers will be credited with any amount securitized that exceeds

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the actual transition costs after nuclear units are divested and proceeds applied as mitigation. See Exh. WM-2, p. 8; Exh. DTE1-11. As demonstrated on the record, WMECO will accomplish this by providing a credit against transition charges for unsecuritized amounts on the same bill. In the highly unlikely event that any credit due to ratepayers exceed the transition charges for unsecuritized amounts, WMECO will provide a credit to ratepayers against other charges on the bill. See, Exh. DTE-1-11 ("In addition, while this is not anticipated in any way, should mitigation somehow exceed the buffer provided for the nuclear units, WMECO will provide a credit on another portion of customers' bills to hold customers harmless.").

All the evidence in this proceeding shows that ratepayers will suffer no harm in the unlikely event that transition costs turn out to be less than the amount securitized; there is no evidence to the contrary. Moreover, while ratepayers consequently bear no risk from any overestimate of reimbursable transition amounts, an underestimate of the appropriate amount to be securitized would fail to capture maximum savings for ratepayers. The Department should approve WMECO's full, proposed securitization amount.

VI. THE RESTRUCTURING ACT CONTEMPLATES THAT WMECO MAY SECURITIZE NUCLEAR ASSETS BEFORE SUCH ASSETS ARE DIVESTED

In its securitization application, WMECO proposes to issue rate reduction bonds to securitize, among other costs, a portion of the net book cost of its Millstone nuclear unit 2 and 3 generation assets. WMECO submitted a legal memorandum setting forth the reasons WMECO believes securitization of those assets now, before they are divested, is not only consistent with the letter of the Restructuring Act, but furthers the spirit and purpose of the Act. Rather than restate those arguments in full here, WMECO has briefly summarized them and hereby incorporates into this brief the attached legal memo.

In sum, securitization of WMECO's nuclear assets is consistent with the Act because:

There is no requirement in the Act that nuclear assets, the source of the vast majority of transition costs, be divested - let alone divested prior to securitization;

Divestiture of these assets is not necessary to satisfy the Act's requirement that WMECO "fully mitigate" because full mitigation means that WMECO has established a mechanism which extracts from the asset, for the benefit of ratepayers, all residual value in the asset. Here, WMECO has done that through its nuclear performance-based rate-making plan, approved by the Department; and

Permitting securitization of these costs now furthers the Act's central purpose - to reduce consumer electricity rates - because it enables ratepayers to take fullest advantage of the savings created by securitization.

VII. IN THE UNLIKELY EVENT THAT WMICG PREVAILS IN ITS APPEAL OF D.T.E. 97-120 AND DEFERRAL AMOUNTS ARE DISALLOWED, WMECO WILL STILL COLLECT SUFFICIENT REVENUES TO SUPPORT RRB REPAYMENT

WMECO's approved Restructuring Plan permits WMECO to, among other things, defer collection of certain transition costs. WMICG filed an appeal of the Department's approval, styled General Electric Company, et al. v. Department of Telecommunications and Energy, SJ-1999-0574 (the "Appeal"). The crux of the Appeal is that WMECO should not be permitted to defer, and collect later, certain transition costs that WMECO would otherwise be able to recover now but for the initial 10% rate reduction (and subsequent 15% rate reduction) mandated by the Act. WMECO is confident that the Appeal will fail. However in the unlikely event that the appellants prevail, and WMECO is not permitted to defer a portion of its transaction costs for later collection, WMECO will still collect sufficient revenues to support RRB repayment.

WMECO's ability to support RRB repayment even if appellants prevail on the appeal is

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demonstrated in WMECO's response to Exhibit DTE 2-11. As Mr. Soderman explained in that response, WMECO expects to have \$61.258 million in recoverable transition costs in 2000, approximately \$8 million of which will have to be deferred. See Exhibit WM-2, RAS-5, p. 1, lines 10 and 14. However, WMECO expects that it will need only \$16.666 million in revenues to satisfy the 2000 RTC payment. See Exhibit WM-2, RAS-2, p. 2, Col. D. Thus, even if WMECO cannot collect the \$8 million in deferred costs, it will still have \$53.258 million (\$61.258 million in recoverable costs, minus \$8 million in deferred cost) in revenues to satisfy the \$16.666 million necessary to make the 2000 RTC payments. WMECO does not expect any deferrals in subsequent years. Exhibit WM-2, RAS-5, p. 1, line 14. Thus, regardless of the disposition of the Appeal, WMECO, WMECO will have sufficient revenues to satisfy its RTC obligation.

VIII. CONCLUSION

For the reasons set forth above, the Department should approve WMECO's securitization application as filed.

Respectfully submitted,

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Dated: June 30, 2000

CERTIFICATE OF SERVICE

I hereby certify that I caused a true copy of the above document to be served upon the attorney of record for each other party on June 30, 2000.

1. 1 In addition, G.L. c. 59, § 38H, imposes a requirement on an electric company owning nuclear generation facilities in Massachusetts to enter into agreements in lieu of taxes. WMECO owns no interest in any such facility.
2. 2 Mitigation of a further contractual commitment, WMECO's obligation to purchase from Vermont Yankee Nuclear Power Corporation 2.5 percent of the output of the Vermont Yankee nuclear station, is also currently before the Department. See, D.T.E. 00-11. Unlike the buy-down and buy-out of the contracts that are the subject of D.T.E. 99-56 and D.T.E. 99-101, WMECO is not seeking in this proceeding securitization of the buyout amount of the Vermont Yankee contract. Tr., p. 203.
3. 3 While not obligated to do so to be eligible for securitization, WMECO is now actively engaged in the sale of its share of Millstone unit 2 and Millstone unit 3. See Section V., below. It is expected that the sale of these units will be completed in 2001. Exh. WM-2, p. 6.
4. 4 In Exh. WM-2 (Exh. RAS-2 [securitization scenario], p. 12 of 13), a cost of capital of 11.91% is shown for the remaining distribution company. In Exh. WM-2 (Exh. RAS-3 [no securitization scenario], p. 12 of 13), a cost of capital of 11.23% is shown for the remaining distribution company. It would be incorrect to conclude, however, from a comparison of 11.23% and 11.91% that the cost of capital for the remaining distribution company would, in fact, be lower if there were no securitization. As Mr. Soderman explained in testimony (Tr., pp. 220-223), this is because the calculation in Exh. RAS-3 does not reflect the actual capital structure that would occur in the absence of securitization. The capital structure that produces the 11.23% "cost of capital" would not in fact actually occur. Its 34% assumed equity component would create a company that is far too leveraged with debt. Either the capital structure would have to be adjusted, or the real cost of equity for such a highly leveraged company would be significantly higher than assumed in RAS-3. In either case, the overall cost of capital would be much higher than the 11.23% shown in Exh. RAS-3. See also, Exh. DTE-RR-3.
5. 5 In the Appendix to the Financing Order the function of the "Memorandum Account" is contained within the Collection Account. The Appendix does not specifically refer to a Memorandum Account. See, Appendix to the Financing Order, Article V, Subsections C and F.
6. 6 These costs were subsequently agreed upon by the State Agencies and WMECO, as described in Exh. IR-AG 1-18.
7. 7 This subsection of the Act continues with a clause to assure financing entities that the source of the revenue stream to retire the bonds is not subject to amendment or adjustment: "provided, however, that any such transfers or adjustments shall not effect the rate of transition charges, the collection of such charges, or the transfer to the bondholder trustee of the charges which have been collected." The mechanisms provided for credits to ratepayers for overestimation of securitized

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transition charges thus operate outside of an adjustment to the transition charge rate. G. L. c. 164, § 1G(a)(2).